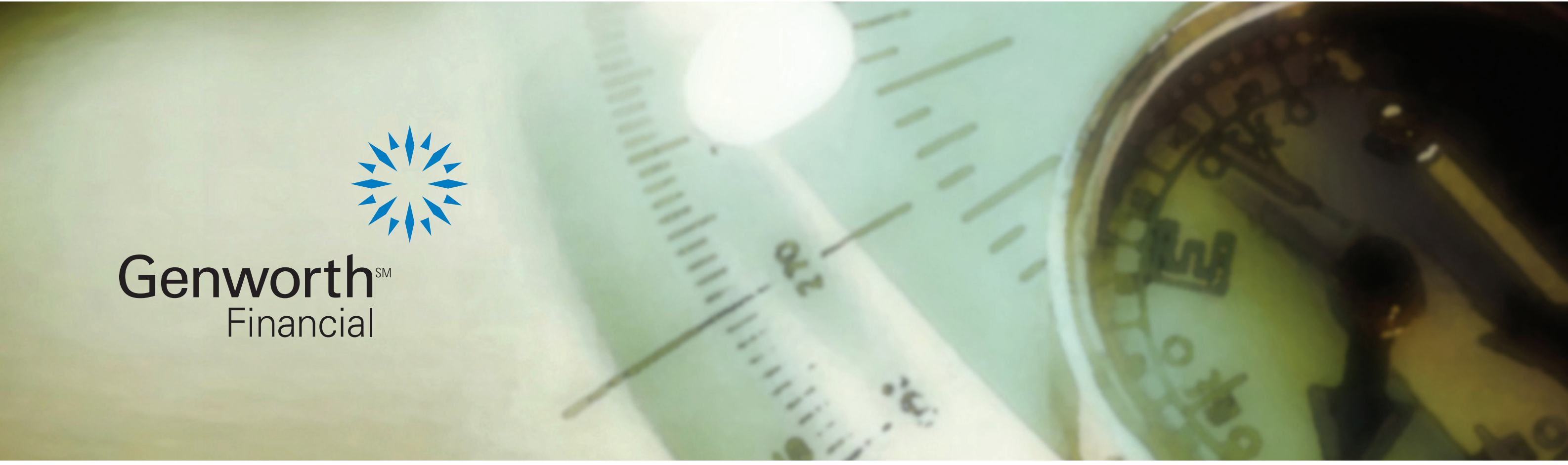

REVIEW AND SITUATIONAL ANALYSIS OF THE UK MORTGAGE MARKET

Contents

Welcome to the third issue of Genworth Financial's UK bulletin – the periodic publication that focuses on topical issues affecting the UK residential mortgage market.

This edition includes an in-depth look at positive data sharing and how current agreements by the BBA and APACS members to adopt full data sharing on credit card and unsecured personal loans by the end of 2005 will benefit the risk management of unsecured lending. It will also assist mortgage lenders to better calculate affordability and encourage an overall transparency in lending decisions.

In this issue, Carina Kemp, Head of Mortgages at HSBC, provides an overview of the biggest obstacles for first time buyers and what lenders can do to help encourage them to get on the housing ladder.

In our final article, we take a closer look at the Government's approach to providing affordable homes and examine the HomeBuy consultation, in particular the Shared Equity Scheme. We look at possible solutions which the ODPM could address to make the scheme a viable and commercial proposition for lenders.

We are also pleased to introduce a new section on the European mortgage market. In this section, we aim to provide a comparison of the key features of several European mortgage markets where Genworth Financial is active.

This quarter we are excited about Genworth Financial's sponsorship of the "Football Fever" themed CML dinner, to be held at the Novotel in Hammersmith. We hope to see many of our readers there.

This will be the last bulletin for 2005 but we look forward to the next publication in 2006. Seasons Greetings and a Happy New Year.

ABOUT GENWORTH FINANCIAL

Genworth Financial (NYSE: GNW) is a leading insurance holding company, serving the lifestyle protection, retirement income, investment and mortgage insurance needs of more than 15 million customers, with operations in 24 countries, including the U.S., Canada, Australia, the U.K. and more than a dozen other European countries. For more information, visit http://www.genworth.com.

In Europe, Genworth is a major provider of mortgage insurance, which helps to expand homeownership through low down payment lending and of payment protection insurance, which helps consumers meet financial commitments if they are unable to work. Genworth's products are distributed through financial institutions and their captives, who offer the products, either in connection with underlying loans or other credit products they sell to their customers, or, as an independent product.

Tammy Richardson
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GF90085 (12/05)

POSITIVE CREDIT RISK DATA SHARING AND RESPONSIBLE LENDING IN THE UK

The majority of the population benefits from the availability and flexibility of credit. Indeed, as the Griffiths Commission notes,[1] "[for] many, if not most people in the UK, being in debt has become a way of life." However, fears over levels of consumer indebtedness are rising as debt charities report increases in both the number of people seeking debt advice and the number of property repossessions,[2] and retail banks report rises in bad debts.[3]

The increase in bad debt provisions has led lenders to consider whether data sharing could reduce levels of over-indebtedness and therefore reduce the risk of borrower default. Lenders currently share data on consumers' largest financial liabilities, such as mortgages, however data sharing on unsecured loans tends to be sporadic and non-uniform, particularly with regard to the sharing of positive data. Positive data is far more comprehensive than negative data and includes information on the size of outstanding balances, the credit limit, the size of payment requirements, a full record of late payments, the length of time the borrower has had credit and the mix of secured and unsecured debt held by the borrower.

Recent discussions have centred on the need for lenders to share positive data with each other, as this is the most relevant for making responsible lending decisions and for tackling over-indebtedness. However, the benefits of sharing positive data extend beyond unsecured lending and can provide important inputs to mortgage lenders affordability calculations; as mortgage lenders would have access to a broader range of information regarding levels of unsecured debt when making lending decisions.

This article focuses on the need for sharing positive data, the benefits of sharing this data, the legal impediments and the wider implications for those lending on a secured basis.

Why Do We Need To Share Data?

The main focus of the discussion recently has surrounded the issue of sharing data on credit card debt. Current figures show that over 21% of the population now hold 4 or more credit cards,[4] and that the annual growth rate for unsecured lending averages above 15%. A culmination of borrowers' increasing sophistication, and the greater availability of unsecured credit has meant that borrowers will tend to shop around for the best deals, rather than maintain relationships with a specific lender. The flexible nature of unsecured lending in general, and credit card lending in particular, increases the importance of having accurate and comprehensive data concerning a borrower's financial commitments, as lenders need to ensure a full understanding of a borrower's credit risk in order to make a responsible lending decision.

An individual institution may have a great deal of data on a borrower, however, unless this can be put into a wider context by accessing data held by other lenders, an understanding of a borrower's full commitments will not be possible. In many cases, a good repayment history is sufficient to encourage lenders to provide new loans. However, without the availability of full data on a borrower, a lender cannot know whether a borrower is repaying more than the minimum balance each month

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1 The Griffiths Commission on Personal Debt, What Price Credit? March 2005, page i.
2 See BBC News Website, Britain Braced for Credit Crunch, 4th October 2005. In the first 3 months of 2005, nearly 26,000 repossession orders were granted, the highest level since 1995.
3 In June 2005, HBOS followed Barclays and HSBC to become the third high street lender to warn of rising levels of bad debt.
4 See Treasury Select Committee, Second report – Credit Card Charges and Marketing, HC 274, 4th February 2005, paragraph 52.
5 Bank of England, Financial Stability Review, Issue 18, June 2005, page 17.

on other credit cards, or whether they are "borrowing from Peter to pay Paul". Accurate credit assessments are vital for a full understanding of the credit risk that a borrower poses, and are heavily dependent on the availability of positive "predictive" data on borrower characteristics and behaviours.

The Recommendations for Data Sharing

Various Governmental and independent panels have reviewed the issue of consumer debt, and have concluded that the industry needs to share data in order to ensure that lenders are making responsible lending decisions, and borrowers are not becoming over-indebted.[6]

All members of the BBA and APACS have committed to full data sharing on credit cards and unsecured personal loans by the end of 2005. This will mean an increase of 6 million additional credit accounts shared, which roughly equates to 11% of the market. In addition, some lenders have agreed to share current account information, although some are unwilling to share data on overdraft balances below £1250.[7] The Finance and Leasing Association (FLA) is also negotiating with the Department of Education and Skills (DfES) to share data on student loan accounts.[8]

A number of countries currently use positive data, for example it is widely used in the US and Canada, and is increasingly used in several European countries. In Belgium, Germany and France, it is mandatory for a bank to provide the information required by the Credit Bureaux established by the Central Banks of these countries. In the US, lenders had initial concerns regarding the release of competitive information, however they soon realised that the benefits gained in terms of risk management far outweighed any potential negatives from revealing information on which borrowers might be attractive to another lender.

The Promotion of Responsible Lending

Improvements to the transparency of lending decisions should lead to an increased focus on risk management techniques, and a growth in the sophistication of credit scoring methods for all types of lending – as the greater availability of data is relevant for decisions on both secured and unsecured lending. In practice, this should lead to improvements in affordability assessments and, ultimately, lending decisions. Data sharing will allow lenders to make informed decisions about the amount and the terms on which to lend, and will allow borrowers to access the most appropriate size and kind of credit.[9]

Banks are increasingly reliant on credit scoring mechanisms to make lending decisions as these mechanisms provide lenders with an objective decision. The construction and data requirements of these scorecards differ from lender to lender, however, they each require a broad data set, incorporating credit reference agency data that predicts the potential value of each individual customer and their risk profile. An increase in the availability of positive data will increase the predictive power of scorecards, and will assist in the development of full risk-based pricing. As the Treasury Select Committee noted, "with the increased prevalence of risk-based pricing (determining the customer's interest rate according to their credit record), non-sharing of positive

6 See Treasury Select Committee, Second Report – Credit Card Charges and Marketing, HC 274, 4th February 2005, The Griffiths Commission on Personal Debt (est April 2004 by Oliver Letwin MP), What Price Credit, March 2005 and DTI, Tackling Over-Indebtedness, Annual Report 2005. See also, BBA, A UK Retail Banking Manifesto: Addressing the Challenges that Lie Ahead for the Industry and Its Stakeholders, 29th September 2004, which encourages the industry to lobby the Government to facilitate further data sharing amongst lenders.
7 FLA Issues, Credit Risk/Data Sharing, Date Unknown.
8 This suggestion is supported by the Griffiths Commission on Personal Debt, What Price Credit?, March 2005, page iv.
9 The Griffiths Commission on Personal Debt, What Price Credit? March 2005, page 69.

information may preclude consumers from being eligible for lower rates elsewhere."[10]

Greater use of predictive data could also lead to a minimisation of losses. The Bank of England reported in June that bad debts arising through unsecured lending account for over 90% of major UK banks' write-offs.[11]

Studies undertaken in Asia have shown the difference that even a relatively small amount of additional data can make to the lending decision process. Partially complete positive data, which provided information on open accounts and early delinquencies, generated a 32% reduction in bad debts, compared to the use of negative only data.[12] Fair Isaac has also reported that, in their experience, positive data accounts for approximately 65% of the credit bureau score's predictive power.

However, there is a fine balance between the lenders' need to make responsible lending decisions, and ensuring that lenders do not damage the credit rating of a borrower on the basis of a short-term behavioural change.[13]

Legal Framework

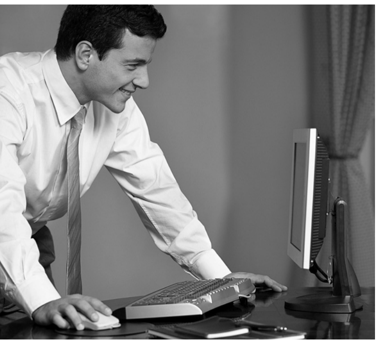
Whilst the case for greater sharing of financial data seems clear, there are certain legal limitations which will need to be addressed before lenders are able to share full data on all accounts with other lenders. The main stumbling block is the Data Protection Act 1998, which requires that data should be processed fairly. This has generally been interpreted to mean that the person who is the subject of the data must have been notified of the purposes for which the data will be used and consented to the data being shared. However, in some cases, lenders did not foresee the widespread sharing of data when opening the account, and therefore did not inform borrowers of their intention to share data in the "fair processing" notice. It would be a breach of the Data Protection Act to share data on these customers without first obtaining their consent. Therefore data on approximately 40 million accounts cannot be not shared for this reason.[14]

The Government's view is that legislation, which complies with the requirements of the European Court of Human Rights, is required to rectify this position. Therefore, the Government is proposing to analyse the need to use historic data further, including the examination of which specific aspects of the data would bring the greatest benefits.[15] However, there is also a possibility that disclosure by banks of positive data without informed express consent would breach the Tournier Principles, which set out the legal duty of confidentiality that financial institutions owe to their customers. This will need to be considered carefully before any legislative changes can be proposed.

10 Treasury Select Committee, Credit Card Charges and Marketing, Second Report of Session 2004 – 05, pp 23-24.
11 Bank of England, Financial Stability Review, Issue 18, June 2005, page 17. In 2004, credit card exposures accounted for over 30% of write-offs, which has trebled since 1998.
12 Fair Isaac, ViewPoints – Sharing Positive Data: The Next Big Step for Emerging Consumer Economies, September/October 2003.
13 Government Response to the Second Report of the Treasury Committee, Session 2004-05, pub. 11th April 2005, response to Recommendation 18.
14 FLA Issues, Credit Risk/Data Sharing, Date Unknown.
15 Government Response to the Second Report of the Treasury Committee, Session 2004-05, published 11th April 2005, response to Recommendation 19.

It had previously been suggested that the issue of the use of historic information could be addressed via an amendment to the Consumer Credit Bill. However the proposed amendment was removed in the third reading of the Bill. Until this issue is resolved, and a workable solution is found, the data on 40 million accounts cannot be shared with other lenders.

Implications for Mortgage Lending



The discussion surrounding the sharing of positive and negative data on credit cards and other forms of unsecured lending tends to be treated separately from the wider issue of affordability. However, Genworth Financial's view is that the data sharing issue is also relevant to discussions on mortgage affordability. Although the Treasury Select Committee recognised that mortgage data is currently shared between lenders, it can only be a positive thing for mortgage lenders to have a greater amount of information regarding a borrower's levels of unsecured debt when calculating mortgage affordability. The FSA regulations on mortgage lending contain a requirement for responsible lending on the part of mortgage lenders. Therefore, the greater accessibility of information regarding a borrower's total financial obligations, both secured and unsecured, should be viewed as a positive step towards making it easier for lenders to meet this requirement.

In particular, the FLA's attempts to encourage the DfES to share information on student loan debt would be a positive development for mortgage lenders. Figures from the 2004-05 Student Income and Expenditure Survey suggest that students commencing studies in 2005 will leave university with an average debt of £15,000. It is imperative that figures of this size are taken into account when assessing mortgage affordability in order to minimise the risk that the borrower will default on the mortgage payments because of over-indebtedness.

Currently, approximately 15 million people either find their credit commitments a heavy burden or a struggle from time to time.[16] For these borrowers, levels of debt, compared to income, are so high that they will struggle to meet future debt repayments, even in the absence of a major interest rate shock. It is unclear from the figures how many of these people also own their own homes. However, a greater understanding of debt burdens could help to reduce the number of repossessions that take place by ensuring that borrowers are able to manage their financial commitments.

16 The DTI Report, Tackling Over-Indebtedness, Annual Report 2005, page 5 states that around 5% of the population over the age of 18 consider their repayments on unsecured debt to be a heavy burden. The Griffiths Commission on Personal Debt, What Price Credit? March 2005, equates this to approximately 3 million people. A further 12 million people struggle with their credit commitments occasionally.

QUESTIONS & ANSWERS

with Carina Kemp, Head of Mortgages, HSBC

"Every housing market relies heavily on a continued supply of first time buyers to maintain demand and complete the sales chain. In the UK, more than anywhere else, we have seen many potential first time buyers excluded from home ownership through a combination of increased prices, larger deposits, affordability issues and purchase costs. We asked Carina Kemp for her views on the issues facing first time buyers in the UK today."

Q1 - In the UK it is becoming increasingly difficult for first-time buyers to gather the necessary deposit to get on the property ladder. Is this an increasingly common trend here?

Affordability, in the form of a deposit and the amount of monthly mortgage repayments, has been a growing trend since 1993 when first time buyers were at their peak with 35% of all mortgage market activity. Over the ensuing period, until the end of 2004, that figure had declined to just 9%. The main cause of this decline in first time buyers was the growth in house prices, which accelerated from 1997 by an average of over 10% a year and far exceeded growth in personal incomes.

Now, given house prices and interest rates seem to have stabilised, the trend has probably bottomed out.

Q2 - What do you believe are the biggest issues for first-time buyers in the UK today?

In a word, supply – housing supply. The Barker Review highlighted the chronic under supply of affordable housing in relation to demand, particularly first time buyers and those with modest incomes such as key workers. The outlook for interest rates looks reasonably stable so house prices will continue to drive the size of mortgages required and, in turn, be the dominant factor in determining the monthly repayment amounts. Higher or 100% loans to valuation do not help repayment affordability. To reduce monthly repayments requires a reduction in the size of the mortgage. There are three ways to do that:

1. *Put down a larger deposit or share the equity with another party*
2. *Reduce, defer or abolish stamp duty for first time buyers*
3. *Lower house prices*

1. Put down a larger deposit or share the equity with another party

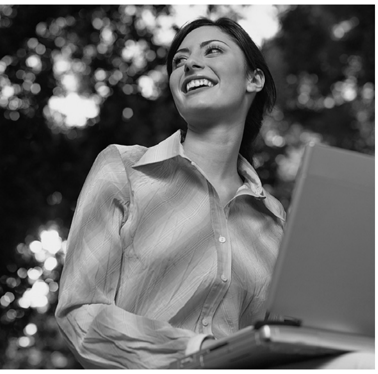
There is a range of schemes designed to assist with this need. They range from Government sponsored shared ownership or equity loan arrangements through to joint ownership with parents/relatives and equity release loans to them to increase the size of deposit.

2. Reduce, defer or abolish stamp duty for first time buyers

The latest change in the stamp duty threshold will help only a relatively small number of first time buyers. There is a need to do more to ease (i.e. reduce the % rate), defer (i.e. capitalise stamp duty on an interest free basis over an extended period) or abolish stamp duty for first time buyers.

3. Lower house prices

Despite a major fall-off in the number of housing transactions, house prices are not reducing significantly. Notwithstanding changes in employment levels, the only prospect of significantly lower house prices is if housing supply increases dramatically, particularly at the 'starter' home end of the housing range.



The Government is working with the public and private sectors to try and find solutions to all of the above but there are difficult hurdles still to be cleared before such initiatives will begin to make a difference.

Q3 - What do you believe lenders can do to help first-time buyers get their first home?

There are four aspects to consider:

1. *Responsible lending and affordability*
2. *Loan to Value percentage (LTV%)*
3. *Monthly repayments*
4. *Supporting Government sponsored schemes where economically practical*

1. Responsible lending and affordability

It is fundamentally important to ensure as far as practically possible that borrowers can afford to keep up the payments on their mortgage and that those payments are protected in the event of accident, sickness or unemployment.

2. Loan to Value percentage (LTV%)

Some borrowers are relatively income rich but capital poor. They can afford relatively high monthly mortgage repayments (which may be lower than the monthly rent they are paying) but having difficulty in building up their savings. For these borrowers a high, even 100% LTV, may be appropriate but lenders have to take a realistic view about their exposure to property prices and its possible impact on their lending security.

Again, a responsible lending approach will give some indication of whether a borrower will be able to weather a house price downturn or period of negative equity. However the timing of a home move is not always of the borrowers choosing so other means of protecting against these risks for borrowers and lenders need to be considered.

3. Monthly repayment

To help with lower initial monthly payments, low cost mortgages such as having interest only payments for the first few years (i.e. HSBC's HomeStart Mortgage) and discounted interest rates are available.

4. Supporting Government sponsored schemes where economically practical

The existing Shared Ownership and Equity Loan (HomeBuy) schemes are supported by most lenders and enable them to have adequate security to support their lending. Newer joint Government/private lender schemes are being considered to try and reach more first time buyers or key workers but they depend on lenders being able to receive an economically viable rate of return without making them unaffordable.

Q4 - In your opinion, do you see UK house prices increasing or decreasing in the next five years?

The probability is that house prices will continue to grow over the next five years but not at the rates seen over the last eight years.

Housing supply is likely to remain below demand and support house price stability and even modest increases. As ever, a major economic downturn, inflation and/or significantly increased unemployment could destabilise the market and undermine confidence. Whilst such developments are possible within the next five years they are at the lower end of probability.

Carina Kemp
Head of Mortgages
HSBC Bank plc

THE ROLE OF MORTGAGE INSURANCE IN THE GOVERNMENT'S HOMEBUY SCHEME

At the beginning of April the Government launched a consultation paper (CP) 'HomeBuy – expanding the opportunity to own' setting out its proposals for reforming low cost home-ownership. The intention of the proposals is to create a simpler and fairer range of home ownership options for more people primarily through equity sharing.

The CP outlined three variants of HomeBuy according to the type of property purchased:

- Social HomeBuy: aimed at helping local authority and housing association tenants to buy, at a discount, a share in the home they currently occupy.

- New Build HomeBuy: aimed at helping key workers, social tenants and those on the housing register and other priority first time buyers to buy a share of a new home built with public subsidy.

- Open Market HomeBuy: aimed at the same target audience as New Build HomeBuy but with the intention of helping those groups purchase a share of a home on the open market.

Of particular interest to the mortgage industry was the summary in Section 7 of the CP ("Encouraging Innovation") on the proposal for a partnership between the Government, the CML and lenders. The key principles of the proposals were as follows:

- The eligibility criteria and level of equity loan assistance to which buyers were entitled would be the same as under the Open Market HomeBuy proposals.

- The buyer would take out a standard mortgage for a portion of the property (a figure of 75% was suggested) with both the mortgage lender and the Government providing an equity loan of 25% (12.5% each) for the remainder of the purchase price.

- A number of lenders would be involved in the scheme to ensure a reasonable level of competition and choice for buyers.

- The buyer would pay an annual charge on the publicly funded equity loan with the potential for lenders to also make a modest charge for the portion of the equity loan provided by them.

- The equity loans would be repaid upon the sale of the property as a proportion of the sale price. The lender's share in any equity increase could be capped.

- In the event of a property being sold for less than its original purchase price the standard mortgage would be repaid first, followed by the lender's equity loan, with the public equity loan having last priority in the order of repayment.

The Government hopes to help an additional 20,000 people over 5 years through this initiative. However, developments over recent months on the public / private equity loan initiative have not augured well for a successful resolution, and the launch date of April 2006 is looking increasingly optimistic. The summer months have seen a steady succession of announcements from lenders stating their withdrawal from the proposed scheme. The underlying reasons behind these withdrawals stem from the fact that, thus far, the Government has failed to do enough to make the scheme a viable commercial proposition for lenders.

Some of the key issues that must be addressed if the Government is to have a broad spectrum of lenders supporting the scheme are:

- **Volumes:** Based on the figure of 20,000 over 5 years, lenders could expect an annual market size of around 5,000 potential buyers. Investment in systems development and training will be required and with such limited volumes it is hard to see how this would make commercial sense.

- **Qualifying lenders:** Under the proposals 'qualifying lenders' are defined as 'banks, building societies or friendly societies'. This excludes a number of major lenders who do not fall within this definition.

- **Risk based pricing:** Through the combination of the standard (75%) mortgage and the two equity loans (25%), buyers under the scheme will effectively have a 100% loan to value (LTV) mortgage. In addition, with the recent increase to the stamp duty threshold, buyers will need relatively little initial capital of their own to fund the purchase of the property. Previous experience shows that the combination of high LTV ratio and stretched affordability increases the risk of default. However, in order to ensure that the affordability of the scheme is not compromised, lenders will have limited scope to price for the additional risk associated with this product.

- **Financial return:** At present it is far from certain that the scheme will be structured in such a way to incentivise buyers to staircase up to full ownership and hence repay the equity loan. In periods of low or even negative house price appreciation, buyers will have little incentive to either staircase up or sell the property, and therefore lenders will also face a challenge when pricing for the cost of the equity loan. In addition, under the new capital requirements coming into force in 2007 it is likely that the equity loan will be risk weighted at 100%, meaning that banks will be required to hold at least 8% capital against this form of lending. This further exacerbates the challenge lenders face in making this a viable commercial proposition.

The Government is providing some level of credit risk protection for lenders through taking a 'third charge', or first loss, position, with their equity loan ranking behind the standard mortgage & lender equity loan in order of repayment. We believe that the Government should consider going a step further by purchasing mortgage insurance to protect both the public and private equity loans in the event of a market downturn, and to safeguard the investment made by the taxpayer.

The core credit risk mitigation provided by mortgage insurance cover on the lender's equity loan would significantly reduce the associated risk and would go some way towards addressing the issue surrounding the pricing of the product, and hence would provide benefits to all parties involved. It would also help lenders to maximize accessibility for buyers, where perhaps without mortgage insurance cover they may not be prepared to do so.

With the current uncertain status of the UK housing market, the timing of this scheme is somewhat unfortunate. To date the Government has accepted house price risk, and has benefited from the significant levels of house price appreciation seen in the UK in recent years. Under the current proposals, the Government will have a larger exposure to house price depreciation, and the question does have to be asked whether the Government should be risking taxpayer's funds, and indeed the future stability of the scheme, to such a degree?

If the Government is to meet the April 2006 launch date for the public / private equity loan scheme, progress over the coming months will be key. If the scheme proposals are to become a reality it is vital that the Government faces up to the significant challenges that are still unresolved and continues a frank and open dialogue with the industry.

OVERVIEW OF THE EUROPEAN MORTGAGE MARKET

We have introduced a new section on the European mortgage market to the bulletin. This section provides a comparison of the key features of mortgage markets across Europe.

If there are any additional statistics that you would like to see in this section, please feel free to contact us.

	UK	Ireland	Portugal	Italy	Sweden	Germany	Spain
% Mortgage Origination to GDP	39.9%	18.4%	6.6%	4.8%	8.5%	4.6%	19.3%
% Mortgage Outstanding to GDP	120%	73%	65%	19%	45%	49%	99%
Average Mortgage Duration (yrs)	25	25	30	15	30-40	25-30	25-30
Interest Rate Type - Fixed - Variable (inc. capped)	 40% 60%	 53% 47%	 97% 3%	 9% 91%	 38% 62%	 95% 5%	 2% 98%
Unemployment Rate	2.7%	4.4%	6.9%	8.1%	5.5%	11.6%	10.4%
Inflation Measures	1.8%	2.7%	2.4%	2.0%	1.0%	1.6%	2.8%
Average HPA	5.7%	7.5%	4.4%	4.0%	8.0%	1.8%	15.7%
Total Population (mm)	60.7	3.9	10.4	57.0	9.0	83.0	41.1
Income Multiples	2.9	4.0	6.4	2.3	2.9	4.6	6.0

Sources: Council of Mortgage Lenders, Economic Intelligence Unit, European Mortgage Federation, European Central Bank, Eurostat, RICS European Housing Review 2005, Consensus Economy, MITA Risk Funding Report, Ireland Department of Trade & Enterprise, Permanent TSB, Bank of Italy, Assofin, Istat - Istituto Nazionale di Statistica, Federal Statistical Office Germany.

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UPCOMING GENWORTH FINANCIAL EVENT

CML Annual Conference And Dinner

Genworth Financial is the title sponsor of this event again in 2005 for the 4th consecutive year. The event will take place on December 6th in London's Novotel Hotel, Hammersmith.